MORTGAGE BANKERS ASSOCIATION
Investing in communities

Statement of David G. Kittle, CMB

Chairman-Elect, Mortgage Bankers Association

before the

Committee on Financial Services

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"A Review of Mortgage Servicing Practices and Foreclosure Mitigation"

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Chairman Frank, Ranking Member Bachus, Members of the Committee, I am David G. Kittle, CMB, President and Chief Executive Officer of Principle Wholesale Lending, Inc. in Louisville, Kentucky and Chairman-Elect of the Mortgage Bankers Association (MBA).[1] I appreciate the opportunity to appear before you to discuss the progress of the mortgage industry in working out troubled loans.

MBA's members strive to keep borrowers in their homes and avoid foreclosures whenever possible. Such goals serve the interests not only of borrowers, but also of our members and of the communities in which they do business. We understand the urgency of borrowers seeking the industry's assistance and our members continue to step up their foreclosure prevention programs.

Avoiding Foreclosures

None of us wants a family to lose its home, and MBA members are devoting significant time and resources to finding ways to help borrowers keep their homes. The tools used to avoid foreclosure and retain a borrower's home include forbearance and repayment plans, loan modifications, refinances and partial and advance claims. Mortgage loan servicers use short sales and deeds in lieu of foreclosure to avoid foreclosure when the borrower does not want to or cannot retain the home.

It makes good economic sense for mortgage servicers to help borrowers who are in trouble. The recent increase in mortgage delinquencies and foreclosures has brought significant attention to the costs of foreclosure to homeowners, communities and mortgage industry participants. While the impact of foreclosure upon homeowners and communities is clear to everyone, statements by some advocates and government officials indicate that confusion still exists about the impact of foreclosures upon industry participants particularly lenders, servicers and investors.

Mortgage lenders and servicers do not profit from foreclosures. In reality, every party to a foreclosure loses – the borrower, the immediate community, the servicer, mortgage insurer and investor. It is important to understand that profitability for the mortgage industry rests in keeping a loan current and, as such, the interests of the borrower and lender are mostly aligned.

As a recent Congressional Research Service paper notes, for lenders and investors, foreclosure is a lengthy and extremely costly process and, generally, a losing financial

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

proposition.[2] While losses can vary significantly, several independent studies have found the losses to be quite significant: over $50,000 per foreclosed home[3] or as much as 30 to 60 percent of the outstanding loan balance.[4]

Risk of Loss

When a lender holds a loan in portfolio, it retains the credit risk on the loan and takes a direct loss if the loan goes to foreclosure sale. When a loan has been securitized, the investors in the mortgage securities hold the credit risk and take a direct loss to principal if the loan goes to foreclosure sale. The servicer, if different from the noteholder, also bears certain costs if the loan goes to foreclosure – most notably the loss of its servicing asset.

Once the borrower has obtained a mortgage and the originator has closed the mortgage, the main objective for the mortgage servicer is to keep the loan current. If a loan is terminated through foreclosure, the servicer does not continue to receive the servicing fee (the primary source of a mortgage company's income). The standard servicing fee for a fixed-rated Fannie Mae or Freddie Mac loan is 1/4 of 1 percent of the principal balance, or $250 per annum for a typical $100,000 loan. Subprime loans generally carry a higher servicing fee because of the increased delinquency risk and costs. Minimum servicing on subprime loans is ½ of 1 percent of the principal balance. Servicers of MBS, otherwise, do not retain the principal and interest (P&I) payment the borrower makes as those amounts are passed on to the ultimate investor.

In addition to losing the servicing income for the asset, servicers must pay out-of-pocket costs when the loan is delinquent. The servicer must:

- Advance interest and principal to the investors (despite not receiving payments from the borrower);

- Advance taxes and insurance payments;

- Pay for foreclosure attorneys fees, court costs and other fees;

- Pay for bankruptcy attorneys and court costs, if applicable;

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[2] See Darryl E. Getter, "Understanding Mortgage Foreclosure: Recent Events, the Process, and Costs," CRS Report for Congress (November 5, 2007), p. 9, 11.
[3] See Desiree Hatcher, "Foreclosure Alternatives: A Case for Preserving Homeownership," Profitwise News and Views (a publication of the Federal Reserve Bank of Chicago) (February 2006), p. 2 (citing a GMAC-RFC estimate); Craig Focardi, "Servicing Default Management: An Overview of the Process and Underlying Technology," TowerGroup Research Note, No. 033-13C (November 15, 2002). See also Congressional Budget Office (CBO), "Policy Options for the Housing and Financial Markets," (April 2008), p. 17.
[4] Karen M. Pence, "Foreclosing on Opportunity: State Laws and Mortgage Credit," Board of Governors of the Federal Reserve System (May 13, 2003), p. 1. See also CBO, p. 17; Community Affairs Department, Office of the Comptroller of the Currency (OCC), "Foreclosure Prevention: Improving Contact with Borrowers," Community Developments (June 2007), p. 3.

• Pay for property inspections and property preservation work (mowing the grass, boarding, rekeying, winterizing, etc.), as applicable;

• Pay for other costs including appraisals, title searches, publications, and other direct costs; and

• Pay for increased staff, contractors and other costs, such as technology costs.

To make principal, interest, tax and insurance advances, mortgage companies have to borrow the funds or use their own capital. These borrowing costs can reach into the millions of dollars per company, as many lenders experienced after Hurricane Katrina and are experiencing today.

State law dictates the foreclosure process and timeline. As a result, foreclosure costs vary significantly from state to state. In certain states, foreclosure requires court action. In these "judicial foreclosure" states, foreclosure takes longer and, consequently, is more costly. Even without a judicial foreclosure, the process is lengthy. The national average time between the first missed payment and the foreclosure sale is approximately one year.[5] After that, it may take additional time to gain possession of the property, clear the title and prepare and sell the real estate owned (REO) property.

If the loan goes to foreclosure sale, the servicer is generally not reimbursed for all its out-of-pocket, direct and indirect costs. For example, the Federal Housing Administration (FHA) only reimburses two-thirds of certain out-of-pocket expenses incurred by the servicer (e.g. foreclosure attorney fees) and sets maximums for foreclosure and bankruptcy costs and property preservation costs that often do not cover the actual expenses. In private label securities, pooling and servicing agreements (PSAs) often establish maximum payments for out-of-pocket costs incurred by the servicers. Moreover, in private label securities, servicers have higher unreimbursed carrying costs because the servicer does not receive reimbursement until it sells the REO property.

Conversely, if the loan is brought current through loss mitigation, out-of-pocket expenses generally are reimbursed through the workout plan or are separately collected by the servicer. Carrying costs are also usually reduced. Curing the delinquency allows the servicer to salvage its valuable servicing asset. Reinstatement, therefore, is far more desirable from an economic standpoint for servicers than foreclosure.

Additional Investor/Noteholder Expenses

Investors and portfolio lenders have added incentives to avoid foreclosure. They incur additional cost and losses as owners of the note or repossessed property. Post

[5] Amy Crews Cutts and William A. Merrill, "Interventions in Mortgage Default: Policies and Practices to Prevent Home Loss and Lower Costs," Freddie Mac Working Paper #08-01 (March 2008), p. 30 and Table 6.

foreclosure costs alone can account for over 40 percent of foreclosure-related gross losses.[6] The main expenses during this phase of the process are:

- ***Costs of restoring the property*** - Often homes of borrowers in financial distress fall into disrepair, requiring repairs and capital improvements to sell the property;

- ***Property Maintenance*** - REO properties must continue to be maintained (grass mowed, property winterized, etc.) and secured (boarded up and rekeyed to avoid break-ins, etc.) and removed of safety code violations (drain and cover pools, etc); and

- ***Real Estate Commissions and Closing Costs*** - Lenders typically use real estate agents, just as individuals do, to sell properties and must pay the real estate broker commissions.

The last step that creates a major expense for investors and portfolio lenders is the loss on the unpaid principal balance that occurs upon the sale of the REO property. While exceptions occur (mostly in appreciating markets), holders of REO properties do not sell them at a gain. REO properties generally do not attract top dollar, and once sale proceeds are netted against the various costs incurred during the delinquency period and foreclosure process, the investor and lender usually end up with losses.[7] These losses make up approximately 20 percent of the total costs of foreclosure. The current softness of the housing market could push this rate even higher. While private mortgage and government insurance and guarantees may offset some of these losses, coverage can be limited. Moreover, not all noteholders are protected by mortgage insurance. Subprime mortgages generally do not carry mortgage insurance.

Loss Mitigation

Mortgage companies and investors have recognized the impact of foreclosures on their bottom lines and over the last ten years have developed innovative techniques to help borrowers resume payments. These options have proven successful for the homeowner, the servicer and investor.

If a homeowner misses a payment and becomes delinquent, the mortgage servicer will attempt multiple contacts with the homeowner in order to help that borrower workout the delinquency. Servicers have several foreclosure prevention options that can get a borrower back on his or her feet, including those outlined below.

Forbearance Plan: Forbearance is a temporary agreement, which allows the homeowner to make partial or no payments for a period. The forbearance agreement is followed by a further evaluation of the loan and the homeowner's circumstance to identify if there are any permanent workout options such as a repayment plan or modification.

[6] Cutts and Merrill, p. 32.
[7] CBO, p. 17; Getter, p. 9; Cutts and Merrill, p. 33.

Repayment Plan: A repayment plan is a verbal or written agreement where a delinquent homeowner resumes making regular monthly payments in addition to a portion of the past due payments to reinstate the loan to "current" status.

Loan Modifications: Loan modifications are the next level of loss mitigation options. A loan modification is a change in the underlying loan document. It might extend the term of the loan, change the interest rate, change repayment terms or make other alterations. Often features are combined to include rate reductions and term extensions. Modifications often provide for the capitalization of arrearages, which means the amount of overdue payments are added to the balance of the loan and the debt is re-amortized. The benefit of this feature is that it brings the loan current, giving the borrower a fresh start.

Loan modifications are one solution for borrowers who have an ability to repay a loan, and have the desire to keep their home, but may need some help in meeting this goal because they cannot meet the original terms of the loan.

Partial and Advance Claims: Servicers are also using partial or advance claims on government and conventional products (i.e., Fannie Mae's HomeSaver Advanced program). In a partial or advance claim, a junior lien is created in the amount of the arrearage. The loan proceeds from the newly created junior lien are used to pay the arrearage on the first mortgage, thus bringing the borrower current. Usually the insurer (FHA or private mortgage insurer) or investor or servicer will hold the junior lien and may defer or forgo interest and may defer principal payments.

Refinances: Servicers also use refinances to assist borrowers who are current, but are at risk of defaulting on the loans in the future or borrowers who are in the early stages of delinquency. FHASecure is one example of a program targeted at borrowers with adjustable rate mortgages who are unable to make payments due to an increase in rate.[8] H.R. 3221, the omnibus housing legislation, enhances FHA's product line by creating the "HOPE for Homeowners" program that creates a refinance program for current and delinquent borrowers who seek to refinance their homes, but find they owe more than their homes are worth.

Short Sales and Deeds in Lieu of Foreclosure: Not all borrowers want to or can stay in their homes. Some have decided to stop making mortgage payments because to do so no longer suits their economic interests.[9] Others face divorce or relocations for which the current home is no longer viable.

Borrowers who cannot maintain their home for whatever reason may still avoid foreclosure through a short sale or deed in lieu of foreclosure. In both cases, the

[8] Mortgagee Letter 2008-13 (May 7, 2008)
[9] See, for example, Said, Carolyn: "More in Foreclosure Choose to Walk Away," San Francisco *Chronicle*: March 16, 2008 (http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/03/16/MNFFVI036.DTL)

borrower is usually relieved of the debt despite selling the house for less than the debt or delivering an asset that is worth less than the debt.

All of these loss mitigation options benefit the borrower in varying ways and servicers strive to help as many borrowers as is prudently possible.

Loss Mitigation is Working

Our servicing members have worked aggressively to make the available tools as efficient as possible. The industry formed the HOPE NOW Alliance in an effort to approach foreclosure prevention in a coordinated fashion and to enhance communication efforts about loss mitigation opportunities with borrowers.

Servicers' actions are clearly working. HOPE NOW estimates that more than 1.7 million homeowners have avoided foreclosure because of industry efforts since July of 2007. In May 2008 alone, servicers provided approximately 170,000 at risk borrowers with repayment and modification plans. Early indications show that servicers are maintaining this pace for June.[10] Of the workout plans offered in May, approximately 100,000 were repayment plans and 70,000 were loan modifications.

Workouts are clearly outpacing foreclosures. In the first quarter of 2008, the number of repayment plans and modifications alone equaled 482,996 as compared with 198,172 foreclosure sales in the same timeframe. Servicers are also engaged in partial or advance claims, delinquent refinances, short sales and deeds in lieu of foreclosure that are not captured currently in the survey. We believe the industry has demonstrated its willingness and commitment to help borrowers avoid foreclosure.

Let me repeat this: despite assertions to the contrary, the numbers are clear. In the first three months of this year, 482,996 families received workouts, more than twice the number of people who experienced foreclosure sales: 198,172. The industry is engaged in an historic effort to assist people in trouble, despite an unending stream of criticism that somehow our efforts are inadequate.

Obviously, the sooner a borrower in trouble can get a workout plan, the greater the chance the borrower has to avoid foreclosure and the less impact there is on the surrounding community. However, servicers cannot forgo due diligence for speed. As some have suggested, granting every borrower a loan modification simply because the borrower requests one is unwise and contrary to the servicer's contractual responsibility to investors or duty to shareholders. As prudent businesses, servicers must review the specific circumstances of the request and tailor the response to the borrower's unique circumstances. Failure to do so would also harm the borrower, as each borrower's financial situation is different, which calls for different solutions.

[10] "Mortgage Loss Mitigation Statistics" HOPE NOW issued July 2008. See http://www.hopenow.com/site_tools/data.php for HOPE NOW data.

Lenders continue to explore ways to improve execution and responsiveness. We recognize that we can do better, and we are working to improve even more. Servicers are increasing staff, sending special mailings, making phone calls, developing Web sites, going door-to-door and using other creative means to reach out to distressed homeowners. As a normal course, servicers send numerous letters to delinquent homeowners notifying them about loss mitigation. Additionally, HOPE NOW launched an additional nationwide campaign to reach at-risk homeowners. So far, HOPE NOW members have sent approximately 1.3 million special letters. About 18 to 20 percent of homeowners receiving the HOPE NOW-coordinated letters have contacted their servicer, a 6- to 9-fold increase over the standard 2-3 percent response rate servicers have historically received.

Industry Action

Servicers have also advanced or promoted several other beneficial programs:

HOPE Hotline: The industry, through the HOPE NOW Alliance, continues to promote the Homeownership Preservation Foundation's HOPE Hotline (888-995-HOPE) which is available 24 hours a day, 7 days a weeks, and 365 days a year. There is no cost to homeowners for using the HOPE Hotline. Part of the explosive increase in calls to the Hotline is the result of the industry's efforts to educate borrowers and to encourage their calls. TV and radio advertisements, billboards and other media are being used to reach distressed borrowers who may be unaware of the existence of loss mitigation options. Borrowers who are in trouble need to contact their servicers, the HOPE Hotline or a trusted advisor. The HOPE Hotline currently has approximately 450 HUD-approved housing counselors available to assist and advise borrowers on mortgages and other debts. However, borrowers must take action. The longer the borrower waits to seek help, the less likely he or she will qualify for loss mitigation.

Streamlined Modifications: Lenders and servicers of HOPE NOW worked with the American Securitization Forum (ASF) to create a framework to more readily modify certain at-risk subprime loans securitized in the secondary market.[11] The focus of the effort has been to identify categories of borrowers with subprime hybrid adjustable rate mortgages (ARM) who can be streamlined into refinancings or modifications. The ASF-established framework is adding to existing efforts to assist distressed borrowers. The key is to find solutions that help borrowers, but do not violate the agreements with investors who now own the securities containing these loans.

Foreclosure Prevention Workshops: Members are working with government agencies, federal and state legislative offices and consumer groups to host foreclosure prevention workshops, where borrowers can meet servicers face-to-face to discuss and execute workout options. These efforts, while worthwhile, are extremely labor intensive,

[11] "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans," American Securitization Forum, December 6, 2007 and updated July 8, 2008. See,http://www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf and http://www.americansecuritization.com/uploadedFiles/ASFStreamlinedFramework7.8.08.pdf

requiring servicing personnel to travel extensively and work long hours and weekends. HOPE NOW has also launched a series of workshops. In the past four months, HOPE NOW alone has connected almost 6,000 homeowners with their lender and/or a HUD-certified housing counselor at workshops in 14 different cities in California, Georgia, Illinois, Pennsylvania, Ohio, Nevada, Texas, Wisconsin, Tennessee, Florida and Indiana.

Use of Third Parties: In addition to the successful use of housing counselors, servicers are also piloting the use of other third parties, such as foreclosure attorneys, to discuss foreclosure prevention alternatives with borrowers. In many cases, the borrower's first communication with the servicer is through the foreclosure attorney. Demand letters and acceleration letters often prompt borrowers to contact the attorney as they recognize the seriousness of the situation. As a result, servicers are seeking ways to use foreclosure attorneys in an efficient and ethical manner to gather information and seek out loss mitigation opportunities. Servicers are also employing third parties to make personal contacts with borrowers at their homes to execute loss mitigation packages.

Innovations with Counselors: The industry, through HOPE NOW and the technology provider Computer Sciences Corporation, have crafted a Web-based tool which housing counselors can use to capture critical borrower information needed to complete a workout by the servicer. The software, called Early Resolution Counseling Portal, is based on technology servicers use in loss mitigation, but it has been adapted for use by counselors to streamline the data collection and transfer of information to servicers. The software can generate a workout recommendation that is based on a particular servicer's or investor's rules and the specific borrower information.

Servicer Best Practices: Servicers working through the HOPE NOW Alliance issued guidelines last month that provide greater clarity and uniformity to the workout process. Of note, the guidelines establish procedures by which mortgage servicers will keep homeowners and authorized third party housing counselors informed about the status of the borrower's requests for assistance. The agreement also establishes a uniform, streamlined timetable for reaching a decision on workout requests. Finally, the agreement creates guidelines for dealing with subordinations and short sales by second lienholders, which have been very challenging issues.

Web Sites: Servicers have also created Web sites that allow borrowers at any time of the day to learn about the loss mitigation process, educate themselves on the requirements, and download or print the financial forms and other documents necessary to initiate the workout process. In some cases, these Web sites are interactive and allow the borrower to fill out the information and submit a request for foreclosure mitigation on-line. The borrower can also mail or fax the forms and request for assistance to the servicer.

Servicer Challenges

The Committee has inquired whether impediments exist that inhibit increased execution of workouts. We would like to take this opportunity to explore some of the more common reasons modifications and other workout strategies fail or are slow to complete.

Investment Properties: The options for helping borrowers who purchased homes as investments are limited. During the housing boom of the last several years, there were many speculators and investors looking to profit from price appreciation. The strength of our economy relies on the willingness of people to take risks, but risk means one does not always get his or her rewards. During this time, a majority of these properties were purchased to try to capitalize on appreciating home values or to use rents as a source of investment income, or some combination of both. With the downturn in the housing market, a number of these investors are walking away from their properties and defaulting on their loans. In the third quarter of 2007, 18 percent of foreclosure actions started were on non-owner occupied properties. Foreclosure starts for the same period for non-owner occupied properties in Arizona, Florida, Nevada and Ohio were at 22 percent.[12]

We understand that this sometimes negatively affects renters who, through no fault of their own, end up impacted by a foreclosure. MBA believes that while the ultimate owners of REO properties should treat renters humanely and ensure sufficient notice, we oppose proposals requiring that any “successor” in interest of a foreclosed property permit a tenant to continue to reside at the property for lengthy periods. Such a requirement hampers the sale of foreclosed properties – the effect of which will be to increase costs for all loans. Further, it may extend the blight on the very communities that are harmed by foreclosures.

Junior Liens: Many borrowers have second and third liens. If the first lienholder seeks to modify the mortgage by adding the arrearage to the balance of the loan – which is common practice to bring the loan current – or seeks to extend the maturity date, the first lienholder must get the junior lienholders to resubordinate their interests to the first lienholder. Failure to get that subordination would jeopardize the first lienholder’s priority position and would likely violate the trust and pooling and servicing agreements.

The process of obtaining a junior lienholder’s subordination is time consuming. Not all second lienholders are willing or permitted by contract to resubordinate their mortgages because doing so erodes their “equity” position. A similar concern arises for junior lienholders when asked to agree to a short sale. In some cases, the short sale will completely wipe out the junior lienholder making this an unattractive option. This does not mean that the borrower is without alternatives. Other loss mitigation approaches can be taken, including repayment plans combined with rate reduction modifications.

[12] Jay Brinkmann, Ph.D., “An Examination of Mortgage Foreclosures, Modifications, Repayment Plans, And Other Loss Mitigation Activities In The Third Quarter Of 2007,” Mortgage Bankers Association (January 2008)

The June HOPE NOW Servicing Guidelines identify these limitations, but also indicate that junior lienholders who are not restricted by servicing agreements to the contrary will resubordinate their interest when:

- a refinancing does not increase the first lien principal amount by more than a reasonable closing costs and arrearages and no cash is extracted by the homeowner; and

- A loan modification that lowers or maintains the monthly payment of the first lien via term extension, rate reduction and or principal write down and no cash is extracted by the homeowner.

Recidivism: Recidivists or serial defaulters are costly to servicers and can create a barrier to repeat offers of loss mitigation. While the industry will consider revising previous modifications or repayment plans based upon true hardship, requests for multiple modifications with no intentions of honoring the terms will – and should – be rejected. Workouts are not free of charge for the servicer. Servicers and investors often incur costs associated with delinquency and foreclosure initiation and those costs mount the longer the delinquency remains outstanding. Servicers also use up valuable resources and incur costs to perform loss mitigation. Borrowers who redefault repeatedly drive up these costs making loss mitigation not viable or financially sound.

One way the industry is attempting to reduce the recidivism problem is to engage in "stipulated payment to modification plans." These "stip to mods" require the borrower to make timely payments according to the proposed revised terms of the mortgage for three or four months. Upon successful completion of the stipulated payment plan, the servicer will execute a modification that formalizes these changes. If the borrower fails to make payments timely during the stipulated payment period, the servicer has the opportunity to determine whether the terms of the plan need to be revised or if the borrower is operating in bad faith and foreclosure is more appropriate. We believe this approach is responsive to the borrower and avoids the incidence of inappropriate modification plans that borrowers cannot keep and that duplicate costs.

Contractual Requirements: Despite many efforts to relieve some of the legal barriers to executing modifications, servicers are under a contractual duty to follow the requirements of their pooling and servicing agreement and to maximize the recovery to the trust. As we have explored in the past, many PSAs permit workouts that are "consistent with industry practice." This poses a challenge to define common industry practice, especially when new approaches such as streamline modifications are undertaken. Others, albeit a minority, prohibit modifications altogether or limit the length of repayment plans. Yet others have conflicting provisions, for example, permitting servicers to follow standard industry practices for delinquent borrowers, but prohibiting changes to the interest rate in other sections of the document. These legal issues are difficult to manage and servicers are reluctant to err against the investor for fear of liability.

While we are certain these limitations or conflicts would be resolved if investors could get together and agree, many MBS are widely held and getting the necessary number of investors together to change the PSA terms has proven impossible. Servicers are not remaining idle, however. Servicers are advancing new concepts by creating industry standards through coordinated approaches led by industry groups and seeking approval of actions by the American Securitization Forum, the SEC and IRS. The industry is working as a whole to obtain favorable results for homeowners while not violating their contracts.

Consumer advocates have placed considerable focus on ensuring that modifications are affordable for the borrower and often request significant concessions from the servicer and investor. Unfortunately, they fail to recognize the servicer's and investor's side of the equation. Servicers are contractually obligated to operate in the best interests of MBS investors. ASF's Streamlined Foreclosure and Loss Avoidance Framework indicates that when evaluating a loan modification, the servicer should compare the anticipated recovery under the loan modification with the anticipated recovery through foreclosure on a net present value basis, and whichever action maximizes recovery should be deemed in the best interests of all investors in aggregate. While servicers consider affordability, if the modification is too rich to the borrower, as some advocates have demanded, the NPV calculation will force a denial. Servicers structure workouts that balance both the borrower and investors' interests and make modifications that do not violate the NPV calculation.

One issue that may inhibit the speed of workouts in the future is H.R. 3221's provision that imposes a fiduciary duty on servicers to maximize the net present value of the pooled mortgage in an investment. Today, servicers have a contractual duty as stated above. By imposing a fiduciary duty on servicers in their execution of loss mitigation, servicers are forced to meet a much higher degree of care toward investors than what may be the case today. We are concerned that a fiduciary standard may slow down workout activity due to the need for even greater due diligence when executing a workout. In some cases, this standard may affect a homeowner's ability to qualify for a workout.

Security Requirements: In some cases, a modification cannot be executed until the borrower is delinquent. For example, Ginnie Mae does not permit a loan to be modified and remain in the security. To modify a loan, it must be repurchased from the pool. Servicers, however, are prohibited from repurchasing a loan from the pool until the borrower is 90 days delinquent. This policy has merit to curb run-off at the security level. Unfortunately, in today's environment, it also inhibits the servicer's ability to execute modifications when a borrower is current -- but default is imminent -- or when the borrower is delinquent by a month or two.

Failure to Respond: While the rate of borrower response has improved dramatically since last year, still far too many borrowers are unresponsive or fail to follow through on workout offers. Some borrowers will request loss mitigation assistance, but when asked to provide necessary documentation, such as income verification or letters describing their financial hardship, the borrowers do not respond. Servicers have also seen borrowers get approved for a modification, but then fail to sign and return a modification agreement that executes the deal. Despite follow up efforts, no action is taken and the servicer is forced to consider the request abandoned. We do not know for certain why these situations are happening. We presume several things. In some cases, the borrower cannot demonstrate a financial hardship. We also believe that the borrower may get overwhelmed with notices and collection calls from other creditors and, therefore, stops opening mail and taking calls. We also believe that some borrowers become suspicious of signing an agreement despite communicating with the servicer. We are sure there are many other reasons. Unfortunately, they are all speculation since servicers are unable to reach these borrowers.

Changing Behavior: Servicers are finding in many cases that borrowers' expenses exceed their income. While income may be sufficient to afford the home and reasonable household expenses, other spending habits and debts incurred by the borrower are draining surplus funds. To retain the home, borrowers must change their spending habits and address their other debts. Servicers are willing to provide assistance by modifying terms of the loan to clear the delinquency and provide more affordable terms. However, borrowers may still also have to negotiate with unsecured creditors to reduce credit card balances in order to continue to afford the home. Servicers are not forcing borrowers to bring down these balances before executing a workout. Servicers will give the borrower the benefit of the doubt and will execute a plan, stop the foreclosure if applicable, and trust that the borrower will take action to reduce their expenses and other debts.

Housing counselors can offer help in this area, by assisting the borrowers with their overall budgets and financial situation. As stated above, servicers are also using more "stip to mods" as a means to ensure the modified payments are affordable and to create better incentives for the borrower to budget their finances. Mortgage lenders, however, cannot be expected to reduce the principal balance on their loans so that their customers can more easily pay unsecured loans, such as credit cards.

Secondary Marketing Risk: Servicers of FHA and VA loans are subject to secondary marketing risk when modifying loans. As stated previously, in order to modify an FHA or VA loan, the servicer must repurchase the loan from the pool. The servicer generally borrows funds from a bank to make the repurchase at the unpaid principal balance. The repurchase obligation creates risk for the servicer. Servicers who repurchase mortgages out of Ginnie Mae securities incur interest rate risk associated with these modifications. Interest rate risk is the risk that the new modified rate offered to the borrower will be below the prevailing market interest rate (par) and the servicer will incur a principal loss for delivering a less valuable asset. Historically the interest rate risk has been far less than the loss from foreclosure. Servicers do not incur redelivery risk with most private label securities because modified loans do not have to be repurchased from pools to be modified.

Conclusion

Servicers want to assist borrowers who are having difficulty paying their mortgages. Not only do servicers want to preserve the client relationship, but servicers and investors have an economic incentive to avoid foreclosure. As a result, servicers are performing a growing number of workouts, including modifications, as evidenced by the HOPE NOW data. Servicers have increased staff, have funded new technology, are sponsoring homeownership workshops and are funding advertising to educate borrowers about foreclosure prevention options. They are paying for housing counseling sessions so that they remain free to homeowners and are working with regulators and others to resolve legal impediments to performing loss mitigation. Servicers are using third parties in innovative ways, even going door-to-door to reach borrowers, and are paying incentives to staff and third parties for successful workouts. All these efforts demonstrate the industry's dedication to avoiding foreclosure and helping delinquent borrowers get back on their feet. The industry is working to keep pace with changes. We are not standing idle, but seeking new and financial responsible ways to increase workouts.

The incentives of the mortgage servicer are generally in line with the borrower who is in trouble. We are doing our part. Thank you for the opportunity to share our thoughts with the Committee. I look forward to answering any questions you may have.